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SUBJECT: PEAK BODY VIEWS ON OIL AND GAS INDUSTRY DOWN UNDER

¶1. (U) SUMMARY. Australia has an expanding LNG sector (see Perth septel) and contracting oil sector. The Australian Petroleum Production and Exploration Association (APPEA) represents both and has argued for increased government incentives and regulatory simplicity to encourage further oil exploration and also successfully lobbied for LNG to be included in the Carbon Pollution Reduction Scheme. It holds that expansion of gas as an energy source could lower Australia's carbon emissions. END SUMMARY.

A RAPIDLY CHANGING INDUSTRY STRUCTURE

¶2. (SBU) The Australian Petroleum Production and Exploration Association (APPEA) is the representative body for the oil and gas industry and its membership includes many large U.S. companies. Over the last five years, the gas and LNG sector has become the centerpiece of investment, while oil production has declined. APPEA CEO Belinda Robinson (who sits on the government's national energy security committee and CSIRO's Energy Committee) is a key industry advocate for the industry and spoke extensively to econ Counselor and econoffs on July 22. Australian LNG is primarily for export, to Japan and other economies in the region, while gas is used for domestic energy and could be used as an input to produce urea and fertilizers. LNG is a major growth opportunity for Australia - with an estimated $220 billion in planned projects. Australia will be a world-class LNG producer by the next decade and this has important implications for energy security in key regional players like Japan, Korea and the PRC, all of whom are increasing their consumption of Australian LNG.

THE OIL AND GAS INDUSTRY

¶3. (SBU) Most oil and gas is sourced from Commonwealth waters adjacent to Western Australia (70% of oil and 50% of gas production), followed by Victoria (20% of oil and gas) and other states. Tax revenue from the oil and gas sector (average A$6 billion a year, last 5 years) is significant and should give the industry more lobbying influence than it has. Most tax revenue from the offshore oil and gas sector goes to the federal government (company tax 47%, royalties and excise 28%, petroleum resources rent tax 25%) and state governments benefit mainly from investment expenditure and employment creation (the future development of the onshore coal seam gas sector in Queensland will more directly benefit state government revenue). Given this strong revenue contribution, it is surprising that the industry is often not consulted over policy decisions of the Rudd government. In 2008,

the sudden elimination of a 30-year tax exemption from excise taxation for crude oil for the North-West Shelf provided "an easy A$2.5 billion" in extra revenue over four years -without much industry dissent (although Woodside's CEO Voelte protested vociferously). Robinson told ECONOFF that U.S. oil and gas companies are reluctant to actively lobby for changes in Australian energy, climate change or taxation policy. This is despite a worsening investment climate due to regulatory complexity and exceptional development costs for oil and gas projects in Australia Qexceptional development costs for oil and gas projects in Australia - one of the highest in the world. Robinson noted that even BHP Petroleum, a major local oil producer, has not actively lobbied the government, or with much success on recent tax increases, the higher costs of the CPRS or the apparent threat of a tougher policy on retention leases.

AN INCREASING OIL AND GAS TRADE DEFICIT?

¶4. (SBU) Australia and its large offshore subsea territories are regarded as a mature oil prospect, but with amazingly rich gas reserves. APPEA has called for more exploration incentives (such as flow-through shares) due to the low incidence of petroleum discoveries around Australia, dwindling supply of reserves and the energy trade deficit. APPEA has emphasized Australia's deficit position in trade in oil and gas since 2003-04, which has been worsening as domestic production falls (see table).

Table 1: Australian Oil and Gas Trade Deficit, 2008 (A$ million)

Category	Exports	Imports	Deficit
Crude oil	11,382	18,122	6,740
LNG	8,708	-	-
LPG	1,228	483	+745
Products	928	16,829	-15,901
Bunkers	1,691	-	+1,691
Total	23,937	35,434	-11,497

Note: Bunker oil is heavy residual oil used as ship fuel oil.
Source: APPEA.

APPEA has sought to reduce regulatory barriers and to increase tax incentives for exploration. It is a strong supporter of flow-through shares, would allow investors to claim up-front tax concessions when investing in smaller exploration companies (which by themselves cannot use tax concessions until they earn income) Resources Minister Ferguson has promised to implement a flow through scheme but there is no clear timetable. The Henry Review on Taxation is now considering the scheme - but APPEA's Robinson is not optimistic it will endorse this approach.

CLIMATE CHANGE POLICY AND OIL AND GAS

¶5. (SBU) Oil and gas account for over 50% of primary energy consumed in Australia (oil 35%, gas 19% in 2007-08) and gas's share is expected to reach 24% by 2030 despite the federal government's reluctance to endorse LNG as a cleaner fossil fuel (40% lower than coal). APPEA has emphasized the lower carbon emission of LNG but is very critical of the Mandatory Renewable Energy Target legislation because it will force the use of higher cost wind and solar renewable energy. This, APPEA fears, will squeeze out the use of low-emissions LNG because power generators and others turn to coal instead as the lowest cost but most carbon-intensive fuel to meet the remaining 80 percent of Australia's power needs. APPEA has claimed LNG is underestimated as a clean fuel and should receive more recognition under the government's Carbon Pollution Reduction Scheme (CPRS) - and not have to suffer from cost imposts as a result of the scheme. Robinson said carbon taxes would exacerbate already high costs in the oil and gas industry. Woodside's CEO

Volte has claimed his company will reconsider future investments and possibly withdraw from Australia entirely if ETS based costs are imposed. Robinson told econoff she is cautious about the credibility of such threats as many companies have nevertheless endorsed future projects despite the CPRS and extra tax imposts - with the government probably willing to lose a few projects if most go ahead. In her view, companies are typically relieved that the CPRS costs are not even higher and the decision of Chevron to approve the massive Gorgon project is just a formality (likely to be announced end-August) and a positive signal for arguments that emissions trading liability costs will be modest.

¶9. (U) COMMENT. The Australian oil and gas industry is undergoing landmark changes as it changes structure and expands as a major world LNG producer. The extent of this transformation depends on the flexibility of government policy in areas such as tax policy and the CPRS. While the positive outlook for world oil and gas prices and regional energy demand continues to underwrite the sector's
Qand regional energy demand continues to underwrite the sector's
future prospects, there are emerging concerns that the investment climate in this sector may be weakened by rising costs and regulatory risk. END COMMENT.

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